

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Market Dominant Product Prices)	Docket No. MC2011-19
First-Class and Standard Mail)	
Discover Financial Services)	
)	
Market Dominant Product Prices)	Docket No. R2011-3
Discover Financial Services (MC2011-19))	
Negotiated Service Agreement)	

**VALPAK DIRECT MARKETING SYSTEMS, INC. AND
VALPAK DEALERS' ASSOCIATION, INC.
COMMENTS ON CONTRACT AMENDMENT TO DISCOVER FINANCIAL
SERVICES NEGOTIATED SERVICE AGREEMENT
(April 2, 2013)**

On March 15, 2011, the Commission approved the Discover Financial Services Negotiated Service Agreement ("Discover NSA"), and added it to the Market Dominant Product List. *See* Order No. 694. On January 31, 2013, the Postal Service executed an amendment to the Discover NSA, and on March 8, 2013, filed a letter with the Commission notifying it of the amendment. The Commission issued Order No. 1676 on March 14, 2013, reopening the docket and inviting comments on the contract amendment. On March 27, 2013, the Commission extended the due date for public comments to April 2, 2013. *See* Order No. 1684. Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. (hereinafter "Valpak") hereby file their Comments regarding the amendment to the Discover NSA.

COMMENTS

I. The Commission Should Reconsider Discover NSA's Basic Compliance with PAEA.

The amendment must be viewed in the context of the performance of the NSA to date. In its FY 2012 Annual Compliance Report ("ACR"), the Postal Service initially asserted that the Discover NSA resulted in a net **increase** to the Postal Service's finances of \$23,567,688 to \$25,513,070. *See* Postal Service library reference USPS-FY12-30. However, a Commission request for additional information revealed that this estimate was not based on Commission-approved methodology, and when calculated properly employing the Commission's methodology, the Discover NSA resulted in a **net loss of \$4,337,569 to the Postal Service in the first year alone.**

The relevant section of PAEA requires, *inter alia*, that an NSA either (i) enhance the Postal Service's operations or (ii) improve the net financial position of the Postal Service. *See* 39 U.S.C. § 3622(c)(10)(A). Enhancement of Postal Service operations is not involved in this NSA. Improvement of the Postal Service's financial position can be done either by reducing Postal Service costs (which the Discover NSA does not purport to do) or by increasing the overall contribution to Postal Service institutional costs. *See* 39 U.S.C. § 3622(c)(10)(A)(i). The basis for the Discover NSA is that it improves the net financial position of the Postal Service by increasing the overall contribution to institutional costs.¹ However, based on the

¹ This is the same prong that the Postal Service used to justify the Valassis NSA in Docket Nos. MC2012-14/R2012-8, and that the Commission recently explained to the U.S. Court of Appeals for the D.C. Circuit was an essential element to that NSA. *See generally* Brief for Respondent Postal Regulatory Commission (Mar. 28, 2013), Newspaper Association of America v. Postal Regulatory Commission (No. 12-1367, D.C. Cir.).

correct information reported in the Postal Service's response to ChIR No. 7, question 8, in Docket No. ACR2012, to date, the Discover NSA has failed to achieve that objective.

In just-completed Docket No. ACR2012, the Commission evaluated the first year of the Discover NSA in its Annual Compliance Determination ("ACD") issued March 28, 2013. The Commission officially found that **year 1** resulted in a net loss of \$4.338 million, which is "inconsistent with section 3622(c)(10)." FY 2012 ACD, p. 158. The Commission invited the Postal Service to terminate the NSA when it concluded that "[i]f the Postal Service is not realizing a net benefit due to the agreement or the insights gained by its implementation [at the end of year 2, *i.e.*, March 31, 2013], the Commission recommends that the Postal Service re-evaluate the benefits and costs of continuing the NSA." *Id.*

Although the Commission in the first instance deferred to the Postal Service, the Commission has authority to terminate an illegal NSA. *See* 39 U.S.C. § 3662. Now that **year 2** of the contract is complete, the Commission should analyze, in this docket, the net financial effect of year 2 as well. If the NSA has lost money again, the Commission should take the initiative and terminate the NSA.

The Commission cannot trust the Postal Service to make a termination decision because the Postal Service believes it is making a great deal of money on the Discover NSA, and that the Commission methodology is flawed. Until the Postal Service yields to the Commission methodology — which has not happened yet — it appears that the Postal Service will want the Discover NSA to continue.

II. Under PAEA, a Hybrid Competitive and Market Dominant NSA Cannot Exist.

In his Motion for Issuance of Commission Information Request (Mar. 21, 2013), the Public Representative (“PR”) explained that the amendment to the Discover NSA “breaches” the wall “that prevents the Postal Service from using its market power over Market Dominant products as leverage to gain an advantage in competitive markets.” PR Motion, p. 3. The PR stated, “At the very least, the Commission is obligated to ascertain whether there is a compelling business need to breach this wall, and the magnitude of the breach that the parties contemplate.” *Id.*

The PR identifies the correct issue, but the Commission has no authority to determine whether a “compelling” need exists based on the statutory language. Section 3642 prohibits the Postal Service from offering a product unless it has been “assigned to the market-dominant **or** competitive category of mail (as appropriate).” 39 U.S.C. § 3642(e) (emphasis added). There is no provision for a dual listing — *i.e.*, for a product that is part market dominant **and** part competitive. Products covered by the postal monopoly are not eligible to be transferred from the market dominant list. 39 U.S.C. § 3642(b)(2). The Postal Service originally proposed the Discover NSA as a market dominant product, and that is precisely how the Commission approved it: “The Postal Service asserts that since the agreement applies to First-Class Mail letters, Standard Mail letters and Standard Mail Carrier Route, **all volume under the agreement, is subject to the postal monopoly.**” Order No. 694, p. 11 (emphasis added). As noted previously, the Discover NSA is classified as market dominant and is included exclusively in the market dominant products list. Now, however, the proposed amendment seeks to incorporate Discover’s Priority Mail volume into the agreement. Priority Mail is

clearly a competitive product. *See* 39 U.S.C. § 3631(a)(1). Such a proposal undermines one of the foundational principles of PAEA — that products are either market dominant or competitive — and such product lists are treated differently throughout PAEA.

The Postal Service’s letter of March 8, 2013 to the Commission does not even mention this obvious legal issue underlying its change, asserting compliance with only two elements of the NSA requirements: “this amendment still meets the statutory requirements of improving the net financial position of the Postal Service, while not causing any unreasonable harm to the marketplace.” Postal Service letter, p. 2. The NSA cannot be a market dominant product which relies on income from competitive products. Nor under that condition can it be included in the market dominant product list.

The Commission needs to be clear on this point. If the Commission’s decision approves the proposed amendment to the Discover NSA, it will set a precedent that will permit all future NSAs to include both competitive and market dominant products. In addition to having a market dominant NSA include competitive products, such a ruling would necessarily allow NSAs for competitive products to rely on volume from market dominant products. The implications of such a decision are profound, and any such radical decision should clearly recognize such an effect and set out a complete legal justification for the decision.

III. The Postal Service Has Not Followed Proper Procedures.

The Postal Service executed the amendment to the Discover NSA on January 31, 2013. The Commission asked the Postal Service for the scheduled effective date of the amendment, stating, “No effective date appears to be specified for the Proposed Amendment.” ChIR No. 3, question 4. Discover signed the amendment on January 24, 2013 and the Postal Service

signed it on January 31, 2013. By its terms, the amendment went into effect immediately upon signing, without Commission approval:

Each party represents that it has caused this Amendment to the Agreement to be executed on its behalf **as of the date written below** by a representative empowered to bind that Party with respect to the undertakings and obligations contained herein. [Amendment (emphasis added).]

Now that the Commission has asked, the Postal Service disregards the amendment language and advises the Commission that “The amendment will be effective the day after the Commission concludes its review....”² Response to ChIR No. 3, question 4.

Thirty-six days after executing the amendment, the Postal Service filed a letter with the Commission to “provide[] notice that it has made a **minor** amendment to the Discover Financial Services Negotiated Service Agreement....” (Emphasis added.) The Postal Service never even requested approval of the change. Nor did the Postal Service state whether the Governors had any involvement in approving the NSA amendment.³ Nonetheless, the Commission graciously treated the Postal Service’s notification letter as a request or a proposal. *See* Order No. 1676, p. 2. To be fair, the Commission’s Rules do not explicitly

² It is still unclear whether the amendment applies to volumes for contract year 3 only, or whether it was quickly executed without Commission approval to prevent a year 2 penalty that was about to occur, or even whether it somehow relates back to year 1. For example, the Postal Service states that “the Postal Service would include the DFS’ Priority Mail volume for the just ended contract year, which represents the shift of volumes described in the response to question 3 above.” Postal Service response to ChIR No. 3, question 7. Taking the Postal Service at its word, the amendment cannot apply retroactively to contract year 2, and absolve penalties which may be owed.

³ Unlike the Valassis NSA, at least the original Discover NSA had an explicit resolution of approval of the NSA by the Governors.

address amendments to NSAs.⁴ However, changing the terms of an approved NSA, no matter how “minor,” triggers the Commission’s review authority.

Finally, the Postal Service did not ask for approval 45 days prior to implementation, as required by 39 C.F.R. section 3010.41. The Postal Service states that the amendment will be effective the day after Commission approval, but unless the Commission waits until April 22, 2013 to approve the proposed NSA amendment, it will have violated the requirement that the Postal Service provide public notice 45 days prior to implementation.

At three different points in Discover’s comments regarding the amendment, Discover claimed that the NSA would penalize Discover for being innovative. *See Discover Comments*, pp. 3-4. However, an important principle of NSAs is that there are consequences to signing contracts. If a participant meets the terms, it receives a discount; if it fails to meet the terms, it receives no discount and may be penalized. By this amendment the Postal Service communicates that it is so enamored of making its NSAs appear successful that it will revise NSAs to make them risk-free for mailers, regardless of the terms of the NSA which it negotiated and signed and which the Commission approved.

CONCLUSION

Under the Discover NSA, we now know that the Postal Service can lose \$4.3 million annually to one mailer without Discover incurring any penalty, without the Postal Service terminating the agreement, and with the Postal Service apparently considering the NSA a success. Moreover, the Postal Service is willing to change the terms of the agreement to

⁴ The Commission could clarify its review procedure as part of Docket No. RM2013-2.

ensure rebates continue. Permitting retroactive, after-the-fact amendments to include unanticipated volumes of mail not even mentioned in the original agreement sets a terrible precedent, and does nothing to improve the methodology for assessing profitability of any NSA, including the one at issue here. If anything, it will invite the Postal Service (and parties to future NSAs) to shoot from the hip in entering a contract that no one believes will be binding and then make up the terms as they go along. To stop such foolish decisions, Congress created the Postal Regulatory Commission.

Respectfully submitted,

William J. Olson
Jeremiah L. Morgan
John S. Miles
WILLIAM J. OLSON, P.C.
370 Maple Avenue West, Suite 4
Vienna, Virginia 22180-5615
(703) 356-5070

Counsel for:
Valpak Direct Marketing Systems, Inc. and
Valpak Dealers' Association, Inc.